

loss under this section. If loss is recognized because stock of a subsidiary became worthless, the disposition with respect to the stock is treated as occurring on the date the stock became worthless. For dispositions and deconsolidations after March 6, 2002 and before March 3, 2005, see § 1.337(d)-2T as contained in the 26 CFR part 1 in effect on March 2, 2005.

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§ 1.337(d)-4 Taxable to tax-exempt.

(a) *Gain or loss recognition*—(1) *General rule.* Except as provided in paragraph (b) of this section, if a taxable corporation transfers all or substantially all of its assets to one or more tax-exempt entities, the taxable corporation must recognize gain or loss immediately before the transfer as if the assets transferred were sold at their fair market values. But see section 267 and paragraph (d) of this section concerning limitations on the recognition of loss.

(2) *Change in corporation's tax status treated as asset transfer.* Except as provided in paragraphs (a)(3) and (b) of this section, a taxable corporation's change in status to a tax-exempt entity will be treated as if it transferred all of its assets to a tax-exempt entity immediately before the change in status becomes effective in a transaction to which paragraph (a)(1) of this section applies. For example, if a State, a political subdivision thereof, or an entity any portion of whose income is excluded from gross income under section 115, acquires the stock of a taxable corporation and thereafter any of the taxable corporation's income is excluded from gross income under section 115, the taxable corporation will be treated as if it transferred all of its assets to a tax-exempt entity immediately before the stock acquisition.

(3) *Exceptions for certain changes in status*—(i) *To whom available.* Paragraph (a)(2) of this section does not apply to the following corporations—

(A) A corporation previously tax-exempt under section 501(a) which regains its tax-exempt status under section 501(a) within three years from the later of a final adverse adjudication on the corporation's tax exempt status, or the filing by the corporation, or by the

Secretary or his delegate under section 6020(b), of a federal income tax return of the type filed by a taxable corporation;

(B) A corporation previously tax-exempt under section 501(a) or that applied for but did not receive recognition of exemption under section 501(a) before January 15, 1997, if such corporation is tax-exempt under section 501(a) within three years from January 28, 1999;

(C) A newly formed corporation that is tax-exempt under section 501(a) (other than an organization described in section 501(c)(7)) within three taxable years from the end of the taxable year in which it was formed;

(D) A newly formed corporation that is tax-exempt under section 501(a) as an organization described in section 501(c)(7) within seven taxable years from the end of the taxable year in which it was formed;

(E) A corporation previously tax-exempt under section 501(a) as an organization described in section 501(c)(12), which, in a given taxable year or years prior to again becoming tax-exempt, is a taxable corporation solely because less than 85 percent of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses; if, in a taxable year, such a corporation would be a taxable corporation even if 85 percent or more of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses (a non-85 percent violation), paragraph (a)(3)(i)(A) of this section shall apply as if the corporation became a taxable corporation in its first taxable year that a non-85 percent violation occurred; or

(F) A corporation previously taxable that becomes tax-exempt under section 501(a) as an organization described in section 501(c)(15) if during each taxable year in which it is described in section 501(c)(15) the organization is the subject of a court supervised rehabilitation, conservatorship, liquidation, or similar state proceeding; if such a corporation continues to be described in section 501(c)(15) in a taxable year when it is no longer the subject of a court supervised rehabilitation, conservatorship, liquidation, or similar

state proceeding, paragraph (a)(2) of this section shall apply as if the corporation first became tax-exempt for such taxable year.

(ii) *Application for recognition.* An organization is deemed to have or regain tax-exempt status within one of the periods described in paragraph (a)(3)(i)(A), (B), (C), or (D) of this section if it files an application for recognition of exemption with the Commissioner within the applicable period and the application either results in a determination by the Commissioner or a final adjudication that the organization is tax-exempt under section 501(a) during any part of the applicable period. The preceding sentence does not require the filing of an application for recognition of exemption by any organization not otherwise required, such as by §§ 1.501(a)-1, 1.505(c)-1T, and 1.508-1(a), to apply for recognition of exemption.

(iii) *Anti-abuse rule.* This paragraph (a)(3) does not apply to a corporation that, with a principal purpose of avoiding the application of paragraph (a)(1) or (a)(2) of this section, acquires all or substantially all of the assets of another taxable corporation and then changes its status to that of a tax-exempt entity.

(4) *Related transactions.* This section applies to any series of related transactions having an effect similar to any of the transactions to which this section applies.

(b) *Exceptions.* Paragraph (a) of this section does not apply to—

(1) Any assets transferred to a tax-exempt entity to the extent that the assets are used in an activity the income from which is subject to tax under section 511(a) (referred to hereinafter as a “section 511(a) activity”). However, if assets used to any extent in a section 511(a) activity are disposed of by the tax-exempt entity, then, notwithstanding any other provision of law (except section 1031 or section 1033), any gain (not in excess of the amount not recognized by reason of the preceding sentence) shall be included in the tax-exempt entity’s unrelated business taxable income. To the extent that the tax-exempt entity ceases to use the assets in a section 511(a) activity, the entity will be treated for pur-

poses of this paragraph (b)(1) as having disposed of the assets on the date of the cessation for their fair market value. For purposes of paragraph (a)(1) of this section and this paragraph (b)(1)—

(i) If during the first taxable year following the transfer of an asset or the corporation’s change to tax-exempt status the asset will be used by the tax-exempt entity partly or wholly in a section 511(a) activity, the taxable corporation will recognize an amount of gain or loss that bears the same ratio to the asset’s built-in gain or loss as 100 percent reduced by the percentage of use for such taxable year in the section 511(a) activity bears to 100 percent. For purposes of determining the gain or loss, if any, to be recognized, the taxable corporation may rely on a written representation from the tax-exempt entity estimating the percentage of the asset’s anticipated use in a section 511(a) activity for such taxable year, using a reasonable method of allocation, unless the taxable corporation has reason to believe that the tax-exempt entity’s representation is not made in good faith;

(ii) If for any taxable year the percentage of an asset’s use in a section 511(a) activity decreases from the estimate used in computing gain or loss recognized under paragraph (b)(1)(i) of this section, adjusted for any decreases taken into account under this paragraph (b)(1)(ii) in prior taxable years, the tax-exempt entity shall recognize an amount of gain or loss that bears the same ratio to the asset’s built-in gain or loss as the percentage point decrease in use in the section 511(a) activity for the taxable year bears to 100 percent;

(iii) If property on which all or a portion of the gain or loss is not recognized by reason of the first sentence of paragraph (b)(1) of this section is disposed of in a transaction that qualifies for nonrecognition treatment under section 1031 or section 1033, the tax-exempt entity must treat the replacement property as remaining subject to paragraph (b)(1) of this section to the extent that the exchanged or involuntarily converted property was so subject;

(iv) The tax-exempt entity must use the same reasonable method of allocation for determining the percentage that it uses the assets in a section 511(a) activity as it uses for other tax purposes, such as determining the amount of depreciation deductions. The tax-exempt entity also must use this same reasonable method of allocation for each taxable year that it holds the assets; and

(v) An asset's built-in gain or loss is the amount that would be recognized under paragraph (a)(1) of this section except for this paragraph (b)(1);

(2) Any transfer of assets to the extent gain or loss otherwise is recognized by the taxable corporation on the transfer. See, for example, sections 336, 337(b)(2), 367, and 1001;

(3) Any transfer of assets to the extent the transaction qualifies for non-recognition treatment under section 1031 or section 1033; or

(4) Any forfeiture of a taxable corporation's assets in a criminal or civil action to the United States, the government of a possession of the United States, a state, the District of Columbia, the government of a foreign country, or a political subdivision of any of the foregoing; or any expropriation of a taxable corporation's assets by the government of a foreign country.

(c) *Definitions.* For purposes of this section:

(1) *Taxable corporation.* A *taxable corporation* is any corporation that is not a tax-exempt entity as defined in paragraph (c)(2) of this section.

(2) *Tax-exempt entity.* A *tax-exempt entity* is—

(i) Any entity that is exempt from tax under section 501(a) or section 529;

(ii) A charitable remainder annuity trust or charitable remainder unitrust as defined in section 664(d);

(iii) The United States, the government of a possession of the United States, a state, the District of Columbia, the government of a foreign country, or a political subdivision of any of the foregoing;

(iv) An Indian Tribal Government as defined in section 7701(a)(40), a subdivision of an Indian Tribal Government determined in accordance with section 7871(d), or an agency or instrumen-

tal of an Indian Tribal Government or subdivision thereof;

(v) An Indian Tribal Corporation organized under section 17 of the Indian Reorganization Act of 1934, 25 U.S.C. 477, or section 3 of the Oklahoma Welfare Act, 25 U.S.C. 503;

(vi) An international organization as defined in section 7701(a)(18);

(vii) An entity any portion of whose income is excluded under section 115; or

(viii) An entity that would not be taxable under the Internal Revenue Code for reasons substantially similar to those applicable to any entity listed in this paragraph (c)(2) unless otherwise explicitly made exempt from the application of this section by statute or by action of the Commissioner.

(3) *Substantially all.* The term *substantially all* has the same meaning as under section 368(a)(1)(C).

(d) *Loss limitation rule.* For purposes of determining the amount of gain or loss recognized by a taxable corporation on the transfer of its assets to a tax-exempt entity under paragraph (a) of this section, if assets are acquired by the taxable corporation in a transaction to which section 351 applied or as a contribution to capital, or assets are distributed from the taxable corporation to a shareholder or another member of the taxable corporation's affiliated group, and in either case such acquisition or distribution is made as part of a plan a principal purpose of which is to recognize loss by the taxable corporation on the transfer of such assets to the tax-exempt entity, the losses recognized by the taxable corporation on such assets transferred to the tax-exempt entity will be disallowed. For purposes of the preceding sentence, the principles of section 336(d)(2) apply.

(e) *Effective date.* This section is applicable to transfers of assets as described in paragraph (a) of this section occurring after January 28, 1999, unless the transfer is pursuant to a written agreement which is (subject to customary conditions) binding on or before January 28, 1999.

[T.D. 8802, 63 FR 71594, Dec. 29, 1998]